How To Avoid PMI And Down Payment On The Rental Wholesale

I've struggled with the best way to do this for years now. And I've finally figured out a method that makes sense for me.

Let's say that you have a rental property that will appraise for $100,000, but you are willing to sell it to another investor for $80,000. That investor wants to buy the property for $80,000, but they don't want to put the $16,000 down that is required by their lender. How do you transfer the property to them and have the bank give them the full $80,000 for the property? Better yet, how do you do this without the new owner having to pay PMI?

At first, when I bought properties from other investors no money down, I used my real estate commission to do so. I took a large enough commission that the commission paid me back for the down payment. The problem with this method is that I was taxed on my commission in the income tax bracket; whereas, I would only be taxed later for capital gains. Thus I was paying a higher tax for the same thing.

Secondly, this obviously does not work if you do not have a real estate license. The problem presented is that if you sell a property to an investor at a discount, they still typically have to put 20% down on the purchase price, not 20% down on the appraised value. In other words, on a $100,000 property, the lender requires the buyer to put $16,000 down on an $80,000 mortgage.

Essentially, the bank is requiring 36% equity in this scenario because they will only lend $64,000 on a $100,000 property. One method that is practiced all the time to avoid this situation is to have the buyer pay cash and then refinance the property at 80% of appraised value – this is an excellent way to do this.

What if the buyer cannot pay cash for the property?

Option 1: The buyer can finance the property and then refinance the property at appraised value if the lender does not have seasoning requirements. This is not an ideal strategy for two reasons. One is that the buyer must pay double closing costs and the second is that they may have to deal with prepayment penalty from the first loan.

Option 2: Sell the property on a land contract or contract for deed, and have the buyer immediately refinance. Only do this with a buyer that you know and trust. Then, the buyer immediately refinances through a bank. Some local lenders allow the immediate refinance of a property; others require 3, 6 or 12 months seasoning.

If you sell it to somebody with owner financing, this is consider a full transfer and can often be immediately refinanced (even though the new buyer may have put nothing down). If the property appraises for 20% higher, the new buyer can immediately refinance at 80% of the new appraised value ($100,000), thus getting into the deal with no money down – or minimal money down. Some lenders will require a 3, 6 or 12 month seasoning. If this is the case, the seller must hold onto the note for 3, 6 or 12 months. This may be a problem for the seller if they are unable to hold the note for this long. By selling with seller financing, the due on sale clause is violated, and the seller probably has to withdraw their own financing – unless they try to avoid the due on sale clause by selling subject to. Assuming a subject to sale is not done, the seller has to have enough cash on hand to pay off their own mortgage for the time it takes to refinance the property.

Selling the property with seller financing could be considered more risky than selling via the land contract. There are pros and cons to each. If the seller has enough cash, he or she can sell via seller financing and potentially get their cash back very quickly. It may only take a couple of weeks. Whereas using the land contract method, it will be a minimum of 3 months but most likely 6 months or more before the new buyer can obtain financing.

Secondly, by using the land contract method, there are many more hoops to jump through with the lender and you need to double check every aspect with the lender before entering into the original land contract.

At the same time, one could argue that the land contract method is less risky because the seller can keep their own financing in place. Plus a default by the new buyer is much easier to correct with a land contract than the foreclosure that is required by a defaulted seller financing transaction.

Since there are so many hassles associated with doing this, why would a seller want to take such risk to sell to a buyer at a 20% discount?

This is not something that all sellers would want to do. However, let's say that you have 10 properties that you want to transfer to somebody else. This buyer and you have a long history of deals together, you know that the buyer can get financing, and you have a high level of trust with them. If the average price for those houses is $100,000, with conventional financing and to avoid PMI, the buyer would have to come up with a total of $200,000 to put down on those houses. If the buyer does not have $200,000, you cannot complete this transaction.

You could, however, transfer the properties perhaps just one or two at a time (to lessen the risk if something goes wrong) to the new buyer in one of the two suggested methods. The new buyer could eventually have all 10 properties with essentially 100% financing while having the advantage 80% financing. In other words, they won't have to pay the increased interest rate, and they will avoid PMI. It just requires a little creativity, lots of trust, lots of patience, and a seller who is willing and able to work with the buyer.

Some people may tell you to simply have the new buyer assume your loans through a 'subject to' transfer. This is an option, only if you trust the new buyer to pay the loan. If the new buyer doesn't have the down payment, I would not trust them to pay my loan. Also, it leaves more mortgages in your name without the benefits of owning the property. This method has too many potential pitfalls for me but is an option. Essentially, you maintain the risk of owning the property without any benefit to you.

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